

## **Introduction**

Implementing the Massachusetts statutory requirements associated with the provision of Enhanced 911, Equal Access to the Telephone Network for People With Disabilities (“Disability Access”), and Directory Assistance (“DA”) charging has required that Verizon Massachusetts (“Verizon MA”) establish an accounting process to match revenues from DA with the costs of E911/Disability Access since 1991. This accounting was necessary because the original legislation funding Enhanced 9-1-1 and the disability access programs required that Verizon MA refund to residential ratepayers revenues received from residence DA charges which exceed Verizon MA’s prudently incurred costs of providing E911 and Disability Access. The Department determined in D.P.U. 91-68 that the mechanism for this refund would be a variable customer dividend or credit to residential customers in their monthly bills. The residential customer dividend was initially set in 1991 at \$.20 per month based upon Verizon MA’s estimate of future revenues and costs over a ten-year period. The customer dividend was, however, eliminated in 1996 because Verizon MA estimated that residence DA revenues would no longer be sufficient to fund the E911/Disability Access costs.

In D.P.U. 91-68, the Department directed Verizon MA to file an annual report of residence DA demand and financial information for the preceding calendar year and to update and explain the revenue/cost estimates. As with prior reports to the Department, this report for 2002 consists of the following:

- Monthly and Annual Residence DA call volumes
- Billable and Suppression rates
- Residence Access lines and Exemptions
- Residence DA revenues
  - E911/Disability Access expenses and investments

In addition, on February 14, 1992, the Department ordered a change in the DA call allowance for Business Centrex and PBX customers. The Department also ordered that Verizon MA track and report on the business DA revenues associated with this change, as well as the business costs associated with E911 and Disability Access.

This report provides the Department with an accounting of the expenses and revenues of the programs for 2002, as well as the cumulative deficit of the fund as of December 31, 2002. This report concludes the twelfth year of the plan with costs exceeding funding by \$34.2M and \$43.1M including interest. Those sections directly related to the reporting of results are included.

In accordance with chapter 239 of the Acts of 2002, the Department opened a rulemaking (D.T.E. 03-24) to establish regulations governing the recovery of expenses that “have been, are, or will be incurred by telecommunications companies in the provision of enhanced 911 service, dual party TDD/TTY message relay service and adaptive equipment services from January 1, 2003 through December 31, 2007” (220CMR 16.01). In addition, the Department has opened an investigation (D.T.E. 03-63) to establish a surcharge to recover the costs associated with the same programs.

### **Variable Customer Dividend**

In its report to the Department for calendar year 1995, Verizon MA showed that residence DA revenue would no longer support the costs of E911 and Disability Access. Therefore, Verizon MA filed with the Department tariff revisions on July 2, 1996, to eliminate the variable customer dividend initially established in 1991. The Department approved that tariff as filed [TT 96-61]. In this report for calendar year 2002, the data shows that DA revenues continue to be insufficient to fund E911/Disability Access expenses, and thus no variable customer dividend is warranted.

## **2002 Residence Results**

The following is a summary of the 2002 Residence Intrastate Revenues and Expenses.

	<b><u>2002</u></b> <b><u>Actual</u></b> <b><u>(000)</u></b>	<b><u>2001</u></b> <b><u>Actual</u></b> <b><u>(000)</u></b>	<b><u>Diff.</u></b> <b><u>(000)</u></b>
Revenues:			
Residence Revenues	\$ 5,056	\$ 7,808	\$ (2,752)
Customer Dividend	<u>0</u>	<u>0</u>	<u>0</u>
Net Revenues	5,056	7,808	(2,752)
Expenses:			
E911	5,670	7,122	(1,452)
Disabilities Access	<u>4,983</u>	<u>5,245</u>	<u>(262)</u>
Total Expenses	10,653	12,367	(1,714)
Net	\$ (5,597)	\$ (4,559)	\$ (1,038)

The following discussion reviews each of these items in detail. Attachment 1 provides the supporting data.

### **Residence Directory Assistance Revenues**

Residence directory assistance revenues declined in 2002. Revenues for 2002 were \$5M<sup>1</sup>, which is \$2.8M or approximately a third lower than actual 2001 revenue. There was a continued reduction in traditional Directory Assistance call volumes due to several factors, including increased competition in the provision of DA services, alternative listing sources (such as CD-ROM and online listings), and customer reaction to DA charging.

As originally projected by Verizon MA, DA calls have significantly declined since DA charging was implemented -- and they continued to decline in 2002. As shown on Attachment 2, the total number of DA calls dropped by 11.5 million calls in 2002 as compared to 2001 call volumes. Actual call suppression, shown on Attachment 3, was 53 percent as of December 2002 (versus December 1990), which is substantially greater than the original estimate of 10 percent.

The continued decline in traditional billable DA calls also continued in 2002. As shown on Attachment 4, the volume of billable calls in 2002 declined by about 3 million calls when compared to 2001 call volumes. This decrease follows a reduction of 2.5 million billable calls in 2001 as compared to 2000, 6.4 million billable calls in 2000 as compared to 1999 volumes, 2 million billable calls in 1999 as compared to 1998 volumes, a reduction of 773,000 billable calls in 1998 as compared to 1997 volumes, a reduction of about 6.4 million billable calls in 1997 as compared to 1996 volumes, a reduction of 400,000 billable calls in 1996 as compared to 1995 volumes, a reduction of 5.2 million calls in 1995 as compared to 1994 volumes, and a reduction of 4.3 million calls in 1994 as compared to 1993 volumes. The DA volumes have continued to decline despite an increase in residential lines which, as shown on Attachment 3, increased by about 106,019 lines as of December 2002 -- or almost 4 percent -- when compared to December 1990.

There has also been a steady increase in the number of individuals who have requested an exemption from DA charging due to a disability. As shown on Attachment 5, there were approximately 22,500 customers with disability exemptions in December 2002, which is approximately 253 more than in December 2001 and almost triple the number of disability exemptions recorded in December 1991.

In summary, the decrease in DA revenues and traditional billable call volumes has occurred -- and continues to occur at a rate that is greater than Verizon MA's original estimates. Increasing competition in the provision of local directory assistance services, via alternative providers, CD ROM technology and Internet alternatives, for example, as well as continued consumer awareness of DA charging, have had and will continue to have an impact on these volumes and the revenues generated by these services.

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<sup>1</sup> 2002 revenues include an adjustment of \$876,614 to correct for an over reporting of revenues in 2001.

## **Expenses**

As shown on Attachment 1, the total combined 2002 expenses were \$18.3 M.

## **Enhanced 911**

The 2002 E911 expenses were \$10M. In 2002, the costs include the relocation of 13 PSAPs and the rearrangement of 50 PSAPs.

Annual recurring costs were approximately \$5.7M. Capital related costs associated with the purchase of equipment totaled \$4.3M for the current year.

Included in this report are expenditures relating to enhancements to the E911 system, primarily PSAP rearrangements and relocations, which total \$0.4M. These expenditures are incorporated into the various line items that comprise the E911 project.

## **Access for People with Disabilities**

Disability Access expenses were approximately \$8.3M. Disability Access expenses are classified into three groupings on Attachment 1.

Annual Recurring	- Relay Center Operations
Annual Recurring Other	- Public Telephone Amplification
One Time	- Specialized CPE (SCPE)

The Specialized Customer Premise Equipment (SCPE) project costs in 2002 were \$1.7M. The Dual Party Relay Service Center expenses totaled \$6.6M. .

## **Conclusion**

Through the first three years of this project, revenues net of the customer dividend exceeded estimated expenses for the planning period. This resulted in a balance in Deferred Credits. However, since 1994, revenues net of customer dividends have been lower than expenses thereby causing deficits in each year. As a result of these deficits, the deferred credit balance from previous years has been reduced to zero. As described above, cumulative costs have exceeded revenues by 34.2\$M<sup>2</sup>. Following is a description of the deferred credit process and accounting entries for prior years, as well as process for tracking the accumulated deficit.

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<sup>2</sup> In April 2003, Verizon back-billed facilities-based and UNE-P Competitive Local Exchange Companies ("CLECs") for wholesale access to the Enhanced 9-1-1 and disability access programs for the period from September 2000 – December 2002. The Department approved a wholesale rate for the service effective September 2000, but due to an administrative error, Verizon did not immediately bill these charges to CLECs. In its 2003 report, Verizon will reduce the overall expenses of the programs by the amount collected from this back-billing, and recalculate the remaining deficit using the same formula it has used in previous reports to determine the residential intrastate portion of the Enhanced 9-1-1 and disability access expenses.

## **Deferred Balance Year End 2002**

To determine the deferred credit balance each month, it was necessary to accumulate the prior month's total intrastate portion of expenses, compare it to the current month's net revenues and increase or decrease the deferred charge balance (Account 4360 on the Balance Sheet) by the difference. In addition, an interest computation is made on the previous month's balance using the interest rate specified by the Department in D.P.U. 91-68.

The actual computation of the deferred credit balance is fairly complex. An illustrative example of how costs and revenues would be handled by the Accounting Plan was provided in response to Department Data Request Set 1-9 in D.P.U. 91-68. This has been included as Attachment 6 of this report.

In order to portray the 2002 results, Attachment 7 is presented in the same format as the previously referenced illustrative example.

The first column on Attachment 7 shows unadjusted results. Actual expenses associated with this undertaking are reported on a "combined" basis, and separated utilizing the FCC prescribed methodology to determine the intrastate portion of the costs. All intrastate costs are further allocated between Residence and Business based on their respective use of the systems. In accordance with the Department's Order in D.P.U. 91-68, a 80%/20% Residence versus Business allocation was included to reflect the appropriate cost combination of residence and business numbers of lines, billed telephone numbers, and total customers.

As shown in L-5 on Attachment 7, of the total 2002 expenses of \$18,310,000, approximately \$ 10,653,000 and \$ 2,663,000 were assigned to intrastate residence and business, respectively.

Residence net revenues (L2+L3) were less than this amount resulting in an annual shortfall of \$5,597,000. Prior to 1996, this difference was transferred or adjusted to the Deferred Credit account. Because there is no longer a deferred credit balance available to offset this shortfall, in accordance with Generally Accepted Accounting Principles (GAAP) rules, no accounting entry was made in 2002. Although Verizon MA cannot include on its financial books an amount owed for the difference between residence DA revenues and E911/Disability Access costs, this difference currently \$ 34.2M is being tracked and included in Attachment 8.

Each month, the accumulated balance is multiplied by a monthly interest rate set at 50 basis points below the average prime rate for Fleet Bank for the preceding calendar year (6.41% in 2002), and this amount is added to or subtracted from the accumulated and included in Attachment 8. In 2002, this amounted to \$ 2,433,000 which was added to the accumulated balance.

### **Internal Controls**

Each month, Verizon MA reviews actual expense and revenue results for reasonableness and summarizes them for distribution to the various operating departments. If a charge that does not belong against the project is incorrectly posted to it, a correcting entry is made in a subsequent month. Likewise, if known expenses are not flowing through to the appropriate job orders, correcting entries are made. These expenses are recognized in the month that the correcting entry clears to the job order. In addition, Verizon MA has historically used its internal auditing organization to perform audits in this area to ensure that the data being used and services being funded are in compliance with the Department's Order in D.P.U. 91-68.

Additionally on December 3, 1999, Verizon MA filed the independent audit report regarding its accounting of residence DA revenues and costs in accordance with the Accounting Plan mandated by the Department in D.P.U. 91-68. The independent auditor concluded that Verizon MA complied with all accounting requirements of the Department.



## **Business Tracking**

The following summarizes 2002 Business DA Intrastate revenues and expenses.

	<b>2002 Actual <u>(000)</u></b>	<b>2001 Actual <u>(000)</u></b>	<b>Diff. <u>(000)</u></b>
Revenue	\$ 825	\$ 1,542	\$ (717)
Expenses:			
E911	\$ 1,418	1,781	(363)
Disabilities Access	<u>1,246</u>	<u>1,311</u>	<u>( 65)</u>
Total Expenses	2,663	3,092	(428)
Net	\$ (1,838)	\$ (1,550)	\$ (288)

In its 1997 report, Verizon MA reported that expenses overran revenues by \$433,000. That trend continued in 1998, 1999, 2000 and 2001, as business expenses overran revenues by \$186,000, \$349,000, \$1,637,000 and \$1,550,000 respectively.